In the Supreme Court of the United States

OCTOBER TERM, 1925

No. 29

THE UNITED STATES, APPELLANT

v.

BOSTON INSURANCE COMPANY

APPEAL FROM THE COURT OF CLAIMS

BRIEF FOR THE APPELLEE

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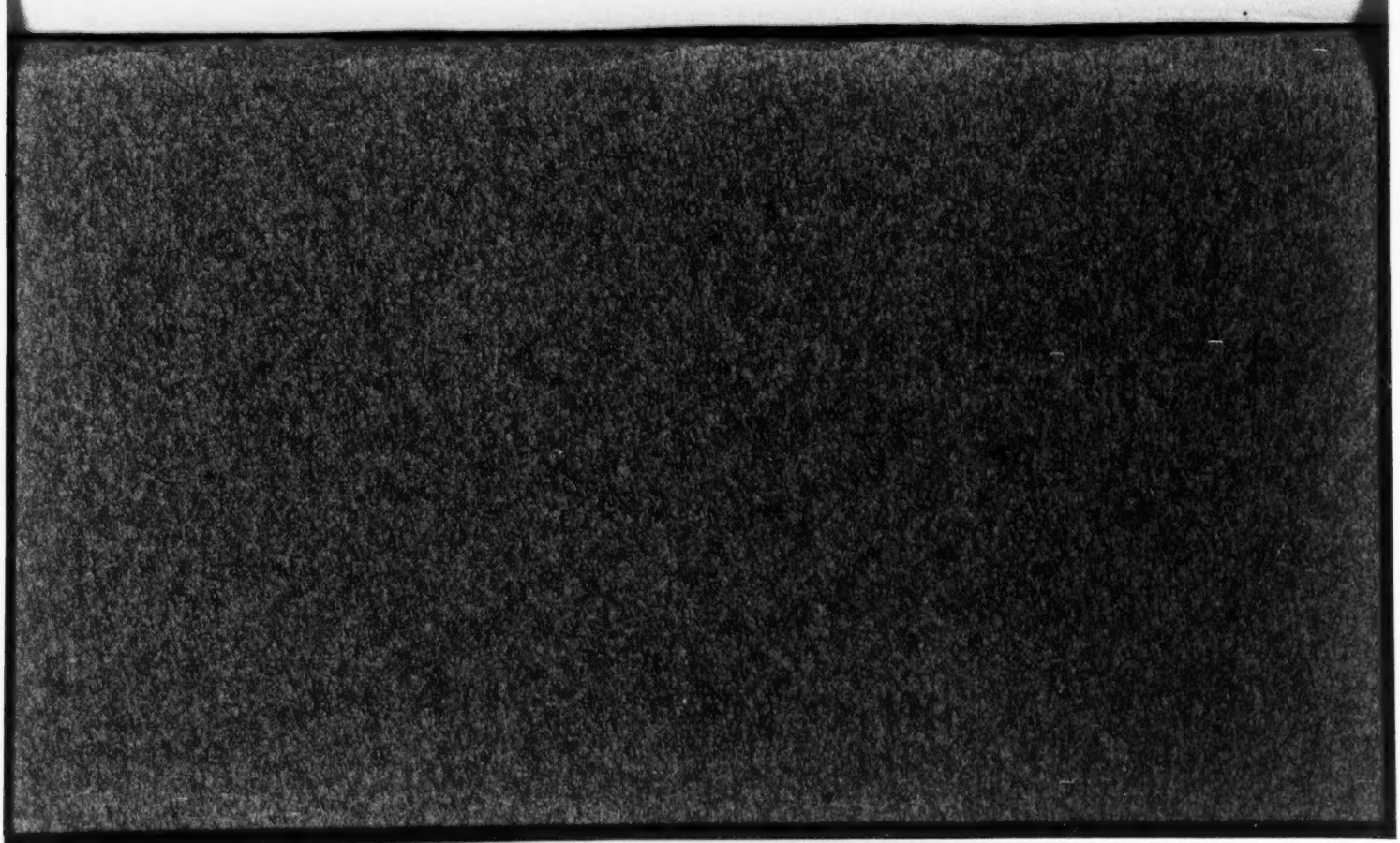

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This is an appeal from a judgment of the Court of Claims. The opinion of that court is reported in 58 Ct. Cls. 603, and is found at page 10 of the record.

This appeal is taken under Section 242 of the Judicial Code from a judgment of the Court of Claims for $8,755.92, with accrued interest thereon at six per centum per annum from December 8, 1917, to November 5, 1923, entered on November 5, 1923, in favor of appellee, (R. 14), hereinafter called the plaintiff.

STATEMENT OF THE CASE

Plaintiff is a Massachusetts stock fire and marine insurance company, which, during the years 1915, 1916 and 1917 transacted its business of making and selling insurance in Massachusetts, and elsewhere, including the State of New York (Finding I, R. 4), where it transacted its said business under the authority of the certificates, or licenses, of the Superintendent of Insurance of said State. (Finding II, R. 5.) On its business of the year 1916,

plaintiff paid, under written protest, Federal income taxes of $3,982.00 on June 15, 1917, and $16,790.65 on December 18, 1917. (Findings III-IV, R. 6.)

On April 30, 1920, plaintiff filed its refunding claim with the Commissioner of Internal Revenue for $20,772.65, on account of the income taxes so paid by it on the business of 1916, which, on January 28, 1922, was adjudicated on the accrued and incurred basis and was allowed for $12,016.73 and rejected for $8,755.92 (Findings V, XI, R. 5, 10). Thereupon plaintiff brought suit in the Court of Claims for the amount so rejected, with accrued interest thereon, on the ground that it was entitled to have the net additions made within the year 1916 to its policy loss claims reserve funds, amounting to $560,678.43, as required by the Superintendent of Insurance of the State of New York deducted from gross income in the computation of its net or taxable income. (Finding V, R. 5–6.)

The New York Insurance Law invested the Superintendent of Insurance for that State with authority (Finding VII, R. 6–9) to require, and he did require, plaintiff to maintain reserve funds covering its unsettled policy loss claims as a condition precedent to the transaction of its business in said State during the years 1915, 1916 and 1917. (Finding VIII, R. 9.)

The Court of Claims entered judgment for plaintiff on November 5, 1923, and this appeal was allowed on January 14, 1924. (R. 14.)

THE ISSUE

The question involved in this appeal is whether the plaintiff, in addition to the deductions previously allowed, is also entitled to have the net additions made to its loss claims reserve funds within the year 1916, as required by the Superintendent of Insurance for the State of New York amounting to $560,678.43, deducted from its gross income in the computation of its net or taxable income for

that year, in accordance with the provisions of Sections 10 and 12 of the 1916 Revenue Act (39 Stat. L. 756, 765, 767).

THE STATUTE

The material provisions of said Sections are as follows:

> Sec. 10. That there shall be levied, assessed, collected, and paid annually upon the total net income received in the preceding calendar year from all sources by every corporation, joint-stock company or association, or insurance company, organized in the United States, no matter how created or organized but not including partnerships, a tax of two per centum upon such income; * * *.
>
> Sec. 12. (a) In the case of a corporation, joint-stock company or association, or insurance company, organized in the United States, such net income shall be ascertained by deducting from the gross amount of its income received within the year from all sources—
>
> First. All the ordinary and necessary expenses paid within the year in the maintenance and operation of its business and properties, including rentals or other payments required to be made as a condition to the continued use or possession of property to which the corporation has not taken or is not taking title, or in which it has no equity.
>
> Second. All losses actually sustained and charged off within the year and not compensated by insurance or otherwise, including a reasonable allowance for the exhaustion, wear and tear of property arising out of its use or employment in the business or trade; * * * and (c) in the case of insurance companies, the net addition, if any, required by law to be made within the year to reserve funds and the sums other than dividends paid within the year on policy and annuity contracts: * * *.
>
> Third. The amount of interest paid within the year on its indebtedness * * *.
>
> Fourth. Taxes paid within the year * * *.

If plaintiff's net additions to its loss claims reserve funds within the year 1916, as required by the Superin-

tendent of Insurance for the State of New York, come within the provisions of subdivision (c), Par. Second of said Section 12, then this question must be answered in the affirmative.

SYNOPSIS OF THE ARGUMENT

The New York Insurance Law invests the Superintendent of Insurance with ample authority to make such requirements as he deems best suited to promote the interests of the people of the State, as a prerequisite to granting or renewing the authority of foreign insurance companies to transact business in that State. The Superintendent of Insurance has exercised this authority by requiring, among others, that such an insurance company shall maintain reserve funds covering its policy loss claims. This requirement is made under appropriate authority of law and, therefore, has the full force and effect of law. The net additions plaintiff was required by the Superintendent of Insurance of the State of New York to make to its loss claims reserve funds during the year 1916 were required by law. The highest court of the State of New York has confirmed the authority of the New York Superintendent of Insurance under which these reserves were required. Plaintiff is, therefore, entitled as a matter of law to have such net additions deducted from its gross income in the computation of its net or taxable income for said year. The case of McCoach *v.* Insurance Company of North America does not control the decision of this case, because the Insurance Commissioner of Pennsylvania is not invested with discretionary power in granting or withholding certificates of authority to transact business in that State, and for other material differences between the New York and Pennsylvania insurance laws. The appellant, hereinafter referred to as the defendant, objects to the deduction of the net addition to loss claims reserves, on the ground that it results in a

double deduction. The clause of the statute providing for this deduction, and also for the deduction of the amounts other than dividends paid to policy holders, is clear and positive and contains no restrictions or limitations whatever upon either of said deductions. Each of these deductions is entirely separate and independent of the other. Therefore, plaintiff is entitled to the allowance of each of these deductions. The court interpretation of taxing acts justifies the allowance of this deduction.

ARGUMENT.

I.

Plaintiff is a Massachusetts corporation which has transacted its business in the State of New York continuously since 1908, and long prior thereto. It is a foreign insurance company within the meaning of Section 56 of the New York Insurance Law, Chapter 28 of the Consolidated Laws of New York and amendments thereto, hereafter called the Insurance Law. Sections 2, 9, 25, 32, 44, 45, and 118 of the Insurance Law are contained in Finding V herein (R. 6-9).

Requirements of Superintendent.

Sec. 2 provides in part as follows:

> There shall continue to be a separate and distinct department charged with the execution of the laws relating to insurance, to be known as the insurance department, the chief officer of which shall be the superintendent of insurance, * * *.

Sec. 9, regarding certificates of authority or licenses to do business in that State, provides in part as follows:

> The superintendent may refuse to issue any such certificate to a domestic or foreign corporation, if, in his judgment, such refusal will best promote the interests of the people of the state.

The following extract from Section 25 recognizes the regulations of the insurance department as having the full force and effect of law:

> Every such foreign corporation and its agents and officers shall always be subject to and be required to make the same statements and answer the same inquiries and be subject to the same examinations, and, in case of default therein, to the same penalties and liabilities as domestic insurance corporations doing the same kind of business, or any of the agents or officers thereof, are or may be liable to under the laws of this state or the regulations of the insurance department.

Sec. 32, regarding the renewal or revocation of certificates of authority of foreign insurance companies, provides in part as follows:

> If the superintendent is satisfied that the capital, securities, and investments remain secure, and that it may be safely intrusted with a continuance of its authority to do business, he shall grant a renewal of such certificate of authority. Whenever in the judgment of the superintendent of insurance it will best promote the interests of the people of this state, he may, after a hearing on notice, revoke the certificate of authority of a foreign corporation to do business in this state, prior to its expiration under this section.

Certainly no more appropriate language could have been employed by the legislature to invest the Superintendent of Insurance with the broadest authority to fix the requirements of an insurance company as a condition precedent to the granting, withholding, renewing, or revoking its certificate of authority to transact its business in said State.

In the exercise of the authority so vested in him by the Insurance Law, the Superintendent of Insurance, by his regulations, required plaintiff to maintain reserve funds

during the years 1915, 1916 and 1917, covering, among others, its unsettled policy loss claims as a condition precedent to the continued transaction of its business in the State of New York. (Finding VIII, R. 9.)

It should here be noted that unearned premiums and policy loss claims constitute the only contractual obligations of plaintiff's contracts of insurance which may require payments of money to its policy holders.

The Superintendent of Insurance did not require the funds reserved on account of plaintiff's loss claims to be kept separate and distinct from its other assets, but did require such funds to be separately specified on plaintiff's books as reserves for unpaid loss claims (Finding X, R. 10).

The regulations under which these requirements were made were in pursuance of appropriate authority of law and not in conflict therewith. It must certainly be admitted that the requirement to maintain reserve funds to cover unsettled loss claims is well adapted to safeguard and "best promote the interests of the people of the State." It would be a strange condition indeed if a reserve was required to protect the interests of policy holders in the unearned portions of the premiums paid by them, amounting to but a few dollars for each policy holder, while no reserve was required to make certain the payment to them of the losses arising under their policies, averaging a far greater amount per loss. It is this situation which has justified the Superintendent's requirement of loss claims reserve funds, in order to best promote the interests of the people of the State. The primary reason for the requirement of insurance reserves is to better protect and safeguard the interests of the policy holders. It was early recognized by the law makers that the individual policy holder was practically helpless in the hands of an unscrupulous insurance company. Therefore, provision was made by the State to require all the reserve funds that might

be necessary to fully safeguard and protect the public in its dealings with insurance companies. This Court has many times affirmed the doctrine of the right of the State to prescribe the conditions under which foreign corporations can transact their business within its borders. See Hooper *v.* California, 155 U. S. 648; 39 L. Ed. 297; The Waters Pierce Oil Co. *v.* Texas, 177 U. S. 28; 44 L. ed. 657; German Alliance Ins. Co. *v.* Lewis, 233 U. S. 389, 59 L. ed. 1011, and the cases cited in these opinions. In the Maryland Casualty Company *v.* United States, 251 U. S. 342; 64 L. ed. 297, this Court held:

> It is settled by many recent decisions of this court that a regulation by department of government, addressed to and reasonably adapted to the enforcement of an act of Congress, the administration of which is confided to such department, has the force and effect of law if it be not in conflict with express statutory provision. United States *v.* Grimaud, 220 U. S. 506, 55 L. ed. 563, 31 Supt. Ct. Rep. 480; United States *v.* Birdsall, 233 U. S. 223, 231, 58 L. ed. 930, 934, 34 Sup. Ct. Rep. 512; United States *v.* Smull, 236 U. S. 405, 409, 411, 59 L. ed. 641–643, 35 Sup. Ct. Rep. 349; United States *v.* Morehead, 243 U. S. 607, 61 L. ed. 926, 37 Sup. Ct. Rep. 458. The law is not different with respect to the rules and regulations of a department of a state government.

See also Davis *v.* Mass. 167 U. S. 533, 41 L. ed. 813.

The court reports of every State contain many opinions giving legal effect to regulations issued under appropriate authority of law by various State, county and municipal departments, boards and commissions. Perhaps the most familiar of these relate to regulations or ordinances concerning police, fire, water, health and building departments of municipalities, but the underlying principle of all of them is the same as for the regulations of a State or Federal department. Where they have been made in pursuance of appropriate authority of law and are not

arbitrary or oppressive, the courts have given them the full force and effect of law. See People ex rel. Doscher *v.* Sisson, 222 N. Y. 387, in which the court says:

> The order of the State Commissioner made pursuant to and within valid statutory authority is to be considered as the act of the state, and in connection with the statutes has the vigor and effect of a statute. (People ex rel Knoblauch *v.* Warden, etc., 216 N. Y. 154; Matter of Stubbe *v.* Adamson, 220 N. Y. 459.)

See also Saratoga Springs, *v.* Saratoga Gas Co., 191 N. Y. 123; Mutual Film Corporation *v.* Ohio Ind. Com., 236 U. S. 230; 59 L. ed. 522; Red "C." Oil Manufacturing Co. *v.* Board of Agriculture, 222 U. S. 380, 56 L. ed. 240.

SUPERINTENDENT'S POWER AFFIRMED BY HIGHEST COURT OF STATE.

The power of the Superintendent of Insurance, under the New York statutes, to exercise his discretion in declining to issue a certificate of authority to transact business in the State of New York, has been affirmed by the New York courts. In People ex rel. Hartford L. & A. Insurance Co. *v.* Fairman, 12 Abbott's N. Y., 252, the facts and holding of the court were in substance as follows: The relator at one time had a certificate allowing it to sell insurance in the State of New York. Its license was threatened to be revoked by the Superintendent, and the relator thereupon changed its name, and applied for a certificate to do business in the State of New York under the new name. The court held, page 259:

> If, on the other hand, this relator having once ceased, as it might, to do business in this State, desired again to renew its business here, then the matter rests with the Superintendent to refuse admission if he thinks best (L. 1873, c. 593, section 2). Nor do I feel sure that an annual request for a renewal of authority is not a new application to be permitted to transact the business of insurance in this State under that section. It is familiar law

that the right of a corporation of another State to do business here depends upon the permission of this State, and a renewal of authority is only a new permission, but it is unnecessary to decide that point.

It is also unnecessary to discuss the merits of the scheme called "Safety Funds Certificate Business," although it is not difficult to see what the operation of it will be in the result. That is a matter, if this be treated as a new application, solely within the discretion of the superintendent.

The case was affirmed on appeal (91 N. Y., 385). That part of chapter 593, section 2, laws of 1873, referred to, is as follows:

> The said superintendent shall have power to refuse admission to any company, corporation, or association, applying to be permitted to transact the business of insurance in this State from any other State or foreign country, whenever, upon examination, the capital of such company, corporation, or association shall be impaired, and also whenever in his judgment, such refusal to admit shall best promote the interest of the people of this State.

The case of People ex rel. Equitable F. & M. Insurance Co. *v.* Fairman. 12 Abbott's N. Y., 268, involved the application of L. 1873, c. 593, sec. 2. The Superintendent declined to issue a license to relator, basing his refusal upon his right to exercise his discretion, provided by the statute, to grant or to withhold from foreign insurance companies the certificate asked for by relator. The relator denied this power and urged that the statute was unconstitutional, as it delegated legislative power to the Superintendent. The request for a writ of mandamus was denied by the lower court and this decision was affirmed on appeal (92 N. Y., 656).

It should be noted that the wording of that part of section 2, chapter 593, L. 1873, empowering the Superintendent of Insurance to exercise his judgment in admit-

ting or refusing to admit a foreign insurance company to do business in the State, is the same to all intents and purposes as appears in section 9 of the insurance law in force during the years 1915 and 1916.

The two decisions above mentioned have become settled law in the State of New York, no further or other case having arisen upon the question of the legal authority of the Superintendent to use his discretion in making such requirements for insurance companies as he saw fit, as a condition precedent to their doing business in the State of New York.

A similar question has arisen under section 91 of the New York insurance law, providing for the issuance of agents' licenses. Section 91 gives to the Superintendent the right "to refuse to issue or renew any such certificate in his discretion," and the question at issue was the right of the Superintendent to decline to issue the certificate or license, basing such refusal upon his exercise of discretion. The powers granted to the Superintendent are not materially different under section 91, covering agents' licenses, from the powers granted to him by sections 9 and 32 of the same law, covering licenses to companies. In Stern *v.* Metropolitan Life Insurance Co., 169 App. Div., 217; 217 N. Y., 626, the court held that under section 91 of the New York Insurance Law the Superintendent had authority to refuse an agents' license and to assign as a reason therefor the exercise of his discretion, and such decision by the appellate division was affirmed by the highest court. It was urged, both in the lower court and in the appellate court, that the granting to the Superintendent of Insurance of the discretionary power to refuse certificates was violative of the Fourteenth Amendment to the Constitution of the United States, by depriving a person of his rights without due process of law. The higher courts of the State of New York, in dealing with this question, based their decision upholding the consti-

tutionality of the insurance law vesting discretionary power in the Superintendent upon the case of New York ex rel. Lieberman *v.* Van De Carr, 199 U. S., 552, 50 L. ed. 305 and particularly upon that part of the opinion of the court reading as follows:

> These cases leave in no doubt the proposition that the conferring of discretionary power upon administrative boards to grant or withhold permission to carry on a trade or business which is the proper subject of regulation within the police power of the State is not violative of rights secured by the Fourteenth Amendment. There is no presumption that the power will be arbitrarily exercised, and when it is shown to be thus exercised against the individual, under the sanction of State authority, this court has not hesitated to interfere for his protection, when a case has come before it in such manner as to authorize the interference of a Federal court.

It therefore follows that under the law of the State of New York the Insurance Superintendent is vested with legal discretion to permit or not to permit foreign insurance companies to transact business within the State of New York. Such authority so to act is vested in him by the statute law of the State of New York, and whatever action he takes is under and by virtue of such statutes. Moreover, the statutes vesting such discretion in the Superintendent of Insurance are legal and valid under the Constitution of the State of New York and also under the Constitution of the United States. In the exercise of such discretion and as a prerequisite to the issuance of a certificate to plaintiff to transact business in the State of New York, the Superintendent required plaintiff to maintain reserve funds sufficient to cover all of its outstanding liabilities. In thus making such requirement the Superintendent acted under the authority vested in him by the statutes of the State of New York and, unless such requirement is arbitrary, the exercise thereof is warranted

by and taken under the State laws and sanctioned by the Federal Constitution.

REASONABLENESS OF RESERVES.

No question is raised as to whether the requirement of the New York insurance department as to reserves for insurance companies was a reasonable requirement. In the case, however, of a charge of arbitrary action on his part, section 118 of the insurance law, provides in detail how and in what manner he shall use his authority in estimating the condition of any fire insurance company. The section requires the Superintendent, in considering the condition of a fire insurance company, to take into consideration all its debts, including unearned premiums, and unsettled loss claims, and all its assets, and in addition thereto he must consider as a liability the capital stock of the corporation. In other words, in arriving at the condition of a fire insurance company, the Superintendent is required to demand that the company shall at all times hold assets in excess of its capital stock in an amount equal to all of its outstanding liabilities. This requirement makes the assets held by the insurance company reserve assets, because they are assets in addition to its capital required to be held, and which they cannot distribute. This was the view taken by the Superintendent's representative in his testimony taken in the case at bar, regarding the effect of this section. In addition thereto, for the purpose of determining the surplus profits of the company subject to distribution, section 117 of the insurance law provides that:

> In estimating the surplus profits of a fire insurance corporation for the purpose of making any dividend upon its capital stock, there shall be reserved from such profits a sum equal to the amount of all unearned premiums on unexpired risks and policies, and all sums due the corporation

on bonds and mortgages, bonds, stock and book accounts, of which no part of the principal or interest thereon has been paid during the last year, and for which foreclosure or suit has not been commenced for collection or which, after judgment obtained thereon, shall have remained more than two years unsatisfied, and on which interest shall not have been paid, and all interest due or accrued and remaining unpaid. But no corporation may declare dividends exceeding ten per centum on its capital stock in any one year unless, in addition to the amount of its capital stock such dividend, all outstanding liabilities and the amount of all unearned premiums on unexpired risks and policies aforesaid, it shall have and be in possession of surplus profits to an amount equalling thirty per centum of its unearned premiums.

Any dividend made contrary to the provisions of this section shall work a forfeiture of the charter of the corporation, and each stockholder receiving any such dividend shall be liable to the creditors of the corporation to the extent of the dividend received in addition to the other penalties and punishments prescribed by law. This section shall not apply to the declaration of scrip dividends by participating corporations. No such scrip dividends shall be paid, except from the surplus profits, after reserving all sums as above provided, including the whole amount of unearned premiums on unexpired risks. And whenever any fire insurance corporation shall have accumulated and be in possession of a fund in addition to the amount of its capital stock, and all actual outstanding liabilities in excess of one-half of the amount of all premiums on risks not terminated such corporation may increase its capital stock from such fund; and distribute such increase pro rata to the stockholders of such corporation, provided, always, that such increase shall be equal to at least twenty-five per centum of the original capital stock of said corporation, and shall have been approved by the superintendent of the insurance department and authorized by at least three-fourths of the board of

> directors of such corporation, and provided, also, that any such corporation may hereafter make and declare a dividend as provided by this chapter.

It will, therefore, be noted that no distribution can lawfully be made except from the surplus profits which are arrived at by deducting the reserve funds from the admitted assets, and even then, only after making the further deductions therefrom required by this section.

Capital stock is not an outstanding obligation of a corporation, but represents the assets of a corporation, against which it incurs liabilities and contracts obligations. Inasmuch as the requirement of the Superintendent of Insurance, that plaintiff should maintain reserve funds in addition to its capital, is but enforcing, by regulation, the maintenance by plaintiff of the requirements set forth in section 118, it cannot be claimed that the Superintendent in making such requirement acted arbitrarily or unreasonably.

INSOLVENCY

Section 118 is not the section of the law which provides the conditions under which an insurance company is insolvent. Section 21 provides when an insurance corporation is insolvent. Under this section, when the assets and credits of a corporation are no longer sufficient to reinsure its outstanding risks, it is insolvent. This section is as follows:

> Every insurance corporation specified in articles two, three, four and five of this chapter, whose assets and credits are not sufficient to reinsure its outstanding risks in a solvent insurance corporation, shall be deemed insolvent and may be proceeded against as an insolvent corporation.

In other words, when the unearned premium reserve is no longer maintained as required, then a fire insurance company is insolvent. Section 118 directs the mainte-

nance of assets greatly in excess of the assets required of a merely solvent insurance corporation. The assets in excess of those required of a solvent insurance corporation by section 118 are those required by the insurance Superintendent to be held as reserve funds in addition to the unearned premium reserve. The question of reserve funds under the New York statute is, then, not a question of solvency or insolvency, as suggested by the defendants' brief, but a question purely of the maintenance of liquid assets largely in excess of those required by a solvent concern for the purpose of making doubly sure the payment of all claims. Assets so required to be reserved by the New York law in excess of assets needed to maintain solvency are reserve funds required by law, and can properly be called by no other name. It therefore follows that the action of the Superintendent requiring reserve funds was appropriately taken under the authority vested in him by the statutes of the State of New York, that such authority was not arbitrarily exercised and that such reserve funds are required by the laws of the State of New York as carried out and made effective through the regulations of the Superintendent of Insurance of that State.

It may be observed as a fact that Finding VIII (R. 9) was based on a certificate of the New York Superintendent of Insurance beginning on page 21 of the Court of Claims record in the case at bar, which specifies the same reserves for stock, fire and marine insurance companies as are specified in this finding. The introductory portion of said certificate is as follows:

> State of New York Insurance Department, Albany.
> Jesse S. Phillips, Superintendent of Insurance.
>
> I, Jesse S. Phillips, superintendent of insurance, do hereby certify that under the statutes and the rules, regulations, and orders of the insurance department

of the State of New York, issued pursuant to powers conferred by law, all insurance companies have been required, since 1908 and prior thereto, as a condition precedent to the transaction of business in the State of New York, to maintain reserves sufficient to cover the following liabilities:

This certificate was executed on November 19, 1920, with full notice of the following extract from the opinion of this Court in Maryland Casualty Company *v.* United States, supra, viz.:

> In this case, as we have seen, the term includes "unearned premium reserve" to meet future liabilities on policies, "liability reserve" to satisfy claims, indefinite in amount and as to time of payment, but accrued on liability and workmen's compensation policies, and "reserve for loss claims" accrued on policies other than those provided for in the "liability reserve," but it has nowhere been held that "reserve," in this technical sense, must be maintained to provide for the ordinary running expenses of a business, definite in amount and which must be currently paid by every company from its income if its business is to continue, such as taxes, salaries, re-insurance and unpaid brokerage.
>
> The requirements relied upon, of the Insurance Departments of New York, Pennsylvania and Wisconsin that "assets as reserves" must be maintained to cover "all claims," "all indebtedness," "all outstanding liabilities," in terms might include the rejected items we are considering, but plainly the departments, in these expressions used the word "reserves" in a non-technical sense as equivalent to "assets," as is illustrated by the Massachusetts requirement that each company shall "hold or reserve assets" for the payment of all claims and obligations. The distinction between the "reserves" and general assets of a company is obvious and familiar and runs through the statements of claimant and every other insurance company. That provision for the payment of ordinary expenses such as we are considering was not intended to be provided for and included in

"reserve funds" as the term is used in the acts of Congress is plain from the fact that the acts permit deductions for such charges from income if paid within the year, and the claimant was permitted in this case to deduct large sums for such ordinary expenses of the business—specifically, large sums for taxes.

It would, therefore, appear that in pursuance of the New York Insurance Law the Superintendent has deliberately and intentionally required plaintiff to maintain reserve funds in fact and not as "assets," for unsettled policy loss claims as enumerated for stock, fire and marine insurance companies in Finding VIII (R. 9) "since 1908 and prior thereto."

Inasmuch as the highest court of New York has decided that the New York legislature did not exceed its powers in authorizing the Superintendent of Insurance to exercise his discretion in granting insurance companies authority to transact business in New York, such question is not an open one in this court and the decisions of the New York court should be followed.

From the foregoing it appears that plaintiff was legally required to maintain reserves for its unsettled policy loss claims as a condition of doing business in the State of New York. It is further apparent that in case plaintiff did not maintain such reserves, its license to continue business in the State of New York could be revoked by the Superintendent of Insurance, or refused by him at the beginning of any year.

In the exercise of the discretionary power vested in the Superintendent of Insurance for the State of New York, he was within his rights in requiring plaintiff to maintain loss claims reserves. He was the chief officer of the Department of New York State charged with the execution of the laws of that State relating to insurance. In the exercise of the discretion vested in him as such Superintendent of Insurance by sections 9 and 32, and also in

accordance with the provisions of section 118, of the New York insurance law, he required plaintiff to maintain these reserve funds. Having made these requirements as Superintendent of Insurance, they were legal requirements and the reserve funds so required to be maintained by plaintiff were reserve funds required by law.

II.

THE CASE OF McCOACH v. INSURANCE CO. OF NORTH AMERICA.

(244 U. S. 585, 61 L. ed. 1333)

The defendant's brief argues at considerable length that the powers of the Commissioner of Insurance for the State of Pennsylvania and those of the Superintendent of Insurance for the State of New York are analogous. However, in doing so it entirely overlooks the provisions of sections 9 and 32 of the New York Insurance Law, vesting the Superintendent of Insurance with discretionary authority of the broadest character regarding the granting, withholding, renewing or revoking of licenses or certificates of authority for insurance companies to transact business in that state.

A careful examination of the statutes comprising the Pennsylvania Insurance Laws, in effect during the years 1915, 1916 and 1917, fails to disclose any similar authority whatever granted to the Commissioner of Insurance for Pennsylvania. It is true that the statutory provisions of the two States are quite similar in regard to the examination of insurance companies by the respective insurance departments of these States, and also regarding certain other points in the regulation of the insurance business in said States. Yet the insurance laws of the two States are divergent in so many material respects that, regardless of whether the court's decision in the McCoach case was right or wrong, that case should have no controlling effect

upon the decision in the case at bar. This is especially true for the reason, among others, that the Pennsylvania Commissioner of Insurance does not appear to have any discretionary authority whatever in regard to requiring reserve funds for the protection of policy holders either as a prerequisite to the securing of licenses or certificates of authority for insurance companies to transact their business in Pennsylvania or otherwise.

Sections 10 and 13 of the 1911 Pennsylvania Laws 607, in regard to the transaction of business in the State of Pennsylvania by foreign insurance companies, provide as follows:

> Section 10: No insurance company of any other State or foreign government shall be admitted and authorized to do business until:
>
> First. It has filed with the Insurance Commissioner a certified copy of its charter or deed of settlement, a statement of its financial condition and business, signed and sworn to by its proper officers, and copies of forms of all policies it proposes to issue in this Commonwealth.
>
> Second. It has satisfied the Insurance Commissioner that it is fully and legally organized under the laws of its State or government to do the business it proposes to transact. That it has, if a stock company, the requisite amount of capital, fully paid up and unimpaired.
>
> Section 13. The Insurance Commissioner shall issue certificates of authority to insurance companies of other States and foreign governments and their agents, and to the agents of Pennsylvania companies, and he may renew the certificate of authority of any mutual assessment life or accident association and its agents, which is now lawfully doing business in this Commonwealth, beginning on the first day of April of each year, and continuing in force for one year unless sooner revoked by him; and any certificates issued after April first shall expire on the thirty-first day of March succeeding. Before granting certificates of authority to an insurance company to

> issue policies or make contracts of insurance he shall be satisfied, by such examination as he may make and such evidence as he may require, that such company is qualified under the laws of this Commonwealth to transact business herein.

These were the statutes in effect regarding the granting of licenses or certificates of authority to foreign insurance companies during the years involved in the present case.

The New York Superintendent of Insurance was vested with such discretionary authority; he has exercised such authority in requiring these reserves, and the highest court of the State has confirmed his right to do so. Nowhere does it appear that the highest court of Pennsylvania has found the Commissioner of Insurance for that State invested with such authority. For the foregoing reasons it is respectfully submitted that the case at bar is in no way controlled or affected by the construction of the Pennsylvania Insurance Laws contained in McCoach *v.* Insurance Co. of North America.

III.

THE SO-CALLED "DOUBLE DEDUCTION."

Reduced to its last analysis, the defendant's argument regarding the so-called double deduction is that the provisions of the Federal taxing statutes, regarding deductions from gross income, and not the State statutes, under which these reserves are required, should determine whether such reserves are required by law. Section 12 of the 1916 revenue act provides that insurance companies shall have all the ordinary deductions granted to other corporations and in addition thereto:

> (c) in the case of insurance companies, the net addition, if any, required by law to be made within the year to reserve funds, and the sums other than dividends paid within the year on policy and annuity contracts.

This language is plain, positive, and unambiguous and no limitations or restrictions whatever are contained either in this section or elsewhere in the act upon the right of insurance companies to enjoy the full benefit of these deductions. However, the defendant argues, in effect, that this section should be construed to read as follows:

> (c) in the case of insurance companies, the net addition, if any, required by law to be made within the year to reserve funds, *or* the sums other than dividends paid within the year on policy and annuity contracts.

There is no authority in the act for such a construction, nor does it anywhere prohibit a double deduction if such a deduction should result from the application of any of the provisions of section 12. In this case, the two deductions are provided for by entirely separate and independent clauses of the sentence. The first deduction consists solely of the net addition required by law to be made to reserve funds; the second deduction consists solely of sums paid within the year on policy and annuity contracts.

It must readily be seen, therefore, that these deductions are not intended to be alternatives, but each is separate and independent of the other. In this connection, it should be pointed out that the Commissioner has allowed the net addition to plaintiff's reinsurance and unearned premium reserves for 1916 and prior years. The official report of the New York Insurance Department, Part I, Fire and Marine (Business of 1916), at page 270, under the head "Income" contains the following:

Gross premiums, Fire		$3,686,956.55
Deduct: Reinsurance premiums	$843,674.83	
Return premiums	640,167.37	
		$1,483,842.20
Total		$2,203,124.35

Gross premiums: Marine and Inland		$4,057,520.78
Deduct: Reinsurance premiums	$765,601.57	
Return premiums	325,851.58	
		$1,091,453.15
Total		$2,966,067.63
Total net premiums written		$5,169,191.98

The Commissioner of Internal Revenue adjudicated plaintiff's refunding claim for 1916 in accordance with his Bulletin "H," Income Tax Rulings Peculiar to Insurance Companies. Par. 17 thereof provides, in part, as follows:

> The premium income of a stock fire insurance company will consist of the gross premiums written during the year, less reinsurance and returned premiums. The result is that stock fire insurance companies will return as premium income for the year the net premiums written as shown by item 7, page 2, of the annual statement, convention edition, rendered to the insurance department.

As will be seen, this paragraph provides for the deduction of reinsurance and return premiums, as shown by the above extract from the report of the New York Insurance Department, and plaintiff's premium income was so used in the adjudication of its refunding claim. Plaintiff's unearned premium reserves are intended to provide for reinsurance and return premiums on all of its policies. As the State Insurance Report shows at page 273, plaintiff at the end of 1916 had policies in force which were written during 1912 and each of the intervening years. Therefore, it is beyond peradventure that some part at least of the amounts deducted for reinsurance and return premiums must have been in connection with policies written during prior years, in which the total net addition to unearned premium reserves had been deducted from gross

income. If the defendant's contention regarding a "double deduction" on account of the net addition to reserve funds be sound, either such portions of the amounts paid during 1916 on account of reinsurance and return premiums should not have been deducted for that year, or the full amount of the net addition to unearned premium reserves for that year should not have been so deducted. The Commissioner of Internal Revenue has properly allowed all of these deductions, because they are provided for by Section 12 of the act and he has never objected to the allowance of any part of them on account of its resulting in a "double deduction." The same condition must be true for each year in which plaintiff's net additions to reserve funds were deducted from gross income. As the net addition must be deducted in its entirety to satisfy this provision of Section 12, therefore, if the defendant's objection were sound that the net addition should not be deducted whenever it results in a double deduction, it follows that no net addition to reserve funds could ever be legally deducted from gross income. This Court appreciated the double deduction question, as shown by the following quotation from its opinion in the Maryland Casualty case:

> It would not be difficult to suggest conditions under which the statutory permit to deduct net additions to reserve funds would result in double deduction in favor of an insurance company, but such deductions can be restored to income again only where it is clearly shown that subsequent business conditions have released the amount of them to the free beneficial use of the company in a real, and not in a mere bookkeeping sense. If this seemingly favorable treatment of insurance companies is to be otherwise corrected or changed, it is for Congress, and not for the courts, to amend the law.

Perhaps the favorable treatment of insurance companies referred to by the Court may be explained by

the following extract, relating to the fire insurance business in the United States during 1916, from a communication from the General Manager of the National Board of Fire Underwriters to the Senate Committee on Finance, found at page 252 of the Hearings and Briefs before the Committee on Finance, United States Senate, Sixty-fifth Congress, First Session, on H. R. 4280:

> The statement of the stock fire insurance companies on the business transacted in the United States for the calendar year 1916, made under oath and verified by the New York Insurance Department, shows that after deducting losses, expenses, and reserves for increase in liabilities but exclusive of taxes, the net underwriting profit was $12,000,966; the taxes paid by the same companies during the year was $12,190,605; producing a final underwriting loss of $189,639.

It is therefore suggested that the defendant's argument regarding a double deduction should have been presented to Congress, rather than to this Court, as it is the court's duty not to make the law, but to interpret it as made by Congress.

IV.

INTERPRETATION OF TAX ACTS.

In United States *v.* Merriam (263 U. S. 179, 68 L. ed. 240) the court holds:

> But in statutes levying taxes the literal meaning of the words employed is most important, for such statutes are not to be extended by implication beyond the clear import of the language used. If the words are doubtful, the doubt must be resolved against the government and in favor of the taxpayer. Gould *v.* Gould, 245 U. S. 151, 153, 62 L. ed. 211, 213, 38 Sup. Ct. Rep. 53. The rule is stated by Lord Cairns in Partington *v.* Atty. Gen. L.R. 4 H. L. 100, 122.

> 'I am not at all sure that in a case of this kind—a fiscal case—form is not amply sufficient; because, as I understand the principle of all fiscal legislation, it is this: If the person sought to be taxed comes within the letter of the law, he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand, if the Crown, seeking to recover the tax, cannot bring the subject within the letter of the law, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be. In other words, if there be admissible in any statute what is called an equitable construction, certainly such a construction is not admissible in a taxing statute, where you can simply adhere to the words of the statute.' And see Eidman *v.* Martinez, 184 U. S. 578, 583.

While the action of the defendant in computing plaintiff's net income, under the Treasury regulation, on the accrued and incurred basis is entirely justified by the facts and in accordance with approved principles of accounting, the defendant has no legal authority to prescribe by regulation that plaintiff shall be deprived of any deduction to which it is legally entitled. In Morrill *v.* Jones, 106 U. S. 466, 467, 27 L. ed. 267 it was held:

> The Secretary of the Treasury cannot, by his regulations, alter or amend a revenue law. All he can do is to regulate the mode of proceeding to carry into effect what Congress has enacted.

This means, in other words, that the Secretary of the Treasury cannot by regulation add to or take from the rights granted by an act of Congress. Therefore, it follows that the defendant cannot by regulation take from plaintiff its right to have the net addition to its loss claims reserve funds within the year 1916 deducted from gross income in the computation of its net taxable income for that year. The language of the statute granting this deduction is perfectly plain, positive and without ambiguity. See also Hecht *v.* Malley, 265 U. S. 144; 68 L. ed. 949.

CONCLUSION.

Inasmuch as the net addition required by the New York Superintendent of Insurance to be made within the year 1916 by plaintiff to its unsettled loss claims reserve funds ~~was~~ were required by law and as plaintiff was not given the benefit of the deduction of such net addition from its gross income in the computation of its net taxable income for 1916 by the Commissioner of Internal Revenue, it is respectfully submitted that the judgment of the Court of Claims should be affirmed.

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